

June 18, 2006

Citizens of Grants Pass
Mayor Holzinger and City Council Members
Budget Committee Members
City Personnel

Fiscal Years 2006-2008 Budget Message

Overview

I am pleased to present to you a balanced and comprehensive operating budget for fiscal years 2006-2008. Grants Pass is a strategically motivated municipality, whose direction is annually defined and affirmed by the governing body through a series of goal statements that reflect the values of the community. These goals are used to formulate a work plan with corresponding performance measurements, together serving as the foundation upon which the budget has been developed. This budget, through its allocation of resources, communicates and defines priorities for the ensuing year while simultaneously insuring sufficient reserves for future needs of local government operations.

Our community, along with much of Southern Oregon, is experiencing many changes as a result of having been “discovered.” Conveniently situated on the I-5 Corridor, Grants Pass provides superior access to dozens of natural amenities from Crater Lake to the Pacific Coast, attracting young families and retirees alike.

Growth continues to generate new jobs, business opportunities and renewed enthusiasm in beautification of our downtown. This growth has also significantly increased the need for municipal services. Our challenge then is to maintain the “livability” of our community while meeting the demands of development and associated infrastructure needs driven by the market. This challenge has impacted virtually every department and division of the corporate municipality of Grants Pass, compelling us to increase service capacity as we remain committed to fiscal

responsibility and the sustainability of essential government services and programs.

City Council Goals

During the January, 2006 City Council retreat, elected officials reaffirmed the importance of maintaining “a home town feel” to the community, a community that:

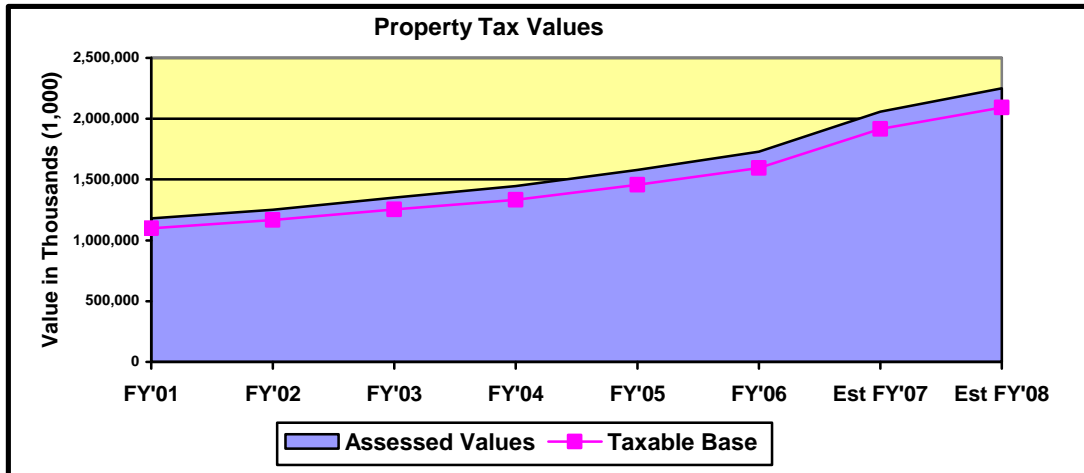
- ▶ Feels safe and IS safe
- ▶ Places emphasis on the central role of the Rogue River
- ▶ Protects our natural environment
- ▶ Enhances and expands parks and recreation opportunities
- ▶ Upgrades our ability to respond to growth, and to effectively manage the impact of growth
- ▶ Assures the opportunity for economic development
- ▶ Provides local government services that are effective and efficient

These important goals are consistently reflected throughout this budget document.

Preparing for Today and the Future:

Housing starts and new commercial developments, together with the rise in property values and annexed lands, have resulted in assessed value growth exceeding 18.99%. This is a particularly positive factor given Oregon’s 3% cap on annual growth of existing property values apart from new construction. With Assessed Values breaking the two billion dollar mark, property taxes over the next two years should be sufficient to cover 100% of the operating costs of Public Safety. While property taxes will continue to be dedicated exclusively to Public Safety operations as they have since 1998, such operations will no longer require additional general fund support as they have in years past.

The November, 2005 annexation of 889 lots on 569.63 acres is anticipated to add about \$119 million in value to the tax roles. A second annexation approved by the voters in May, 2006 added another 583 lots on 277.38 acres, representing \$74.5 million in additional taxable value.



These additional tax revenues provide funding for additional Public Safety staff desperately needed to service an expanding geographical area and population. Additional firefighters have also been provided for in this budget to staff planned new facilities at the corner of East Park Street and the Parkway, and in the vicinity adjacent to Redwood School.

While each department director requested additional staff in the development of this budget, as a group they established priorities giving careful consideration to both financial and political realities. The resulting recommendation is the addition of ten positions in FY'07 and eight in FY'08. Three of the eight positions in FY'08 will be funded by a \$300,000 FEMA grant, estimated to cover employment costs over a 2-year period on a declining scale.

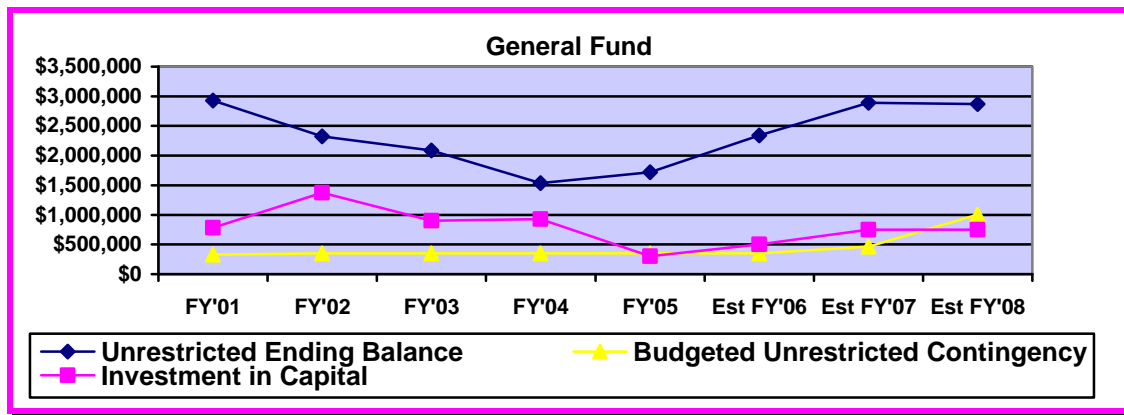
Some requests from department directors have been deferred in anticipation of a compensation study planned for FY'07. The study will evaluate and classify both union and non-union employment positions in terms of supervisory responsibility, interpersonal skills, education, training, physical demands and responsibility to determine the most appropriate competitive wage and benefits for each position. Part of the study will address implementation strategies for the Council to consider.

Summary of FY'07 Personnel Additions		
General Fund	Public Safety – Field	* Police Officer
	Public Safety – Field	Fire Supervisor
	Public Safety – Code Enf.	Community Service Officer
	Parks	Parks Maint. Worker
	Planning	Permit Technician
	Building and Safety	Office Assistant II
	Water Distribution	½ Municipal Service Worker
Water	Sewer Collection	1-½ Municipal Service Worker
Sewer	Admin. Services	Human Resource Manager
Admin. Services	Engineering	Engineering Technician II
Support Services		

* Denotes position was included in the Projected 4-year Public Safety Levy

The Council referred a Prepared Food and Beverage Tax of 4.85% to the May, 2006 ballot for voter approval. Proposed in lieu of a property tax bond measure in November, one-half of the estimated three million dollars in proceeds would benefit public schools. A significant portion, 66%, of the City's share would be dedicated for the construction of two public safety facilities and needed apparatus and equipment. Remaining monies would be allocated for the development and maintenance of parks, trails and outdoor space. This undertaking marked the first time the City and School District #7 joined forces in attempting to raise revenues for their respective needs, other than the traditional property tax levy. Acknowledging from the start the adversity to be overcome from the restaurant industry, leaders from both entities were committed to seeking financial support from visitors, tourists and non-city residents who utilize and enjoy city services. The voters overwhelmingly rejected the measure. The governing body unanimously recognizes emergency response times have faltered as municipal boundaries have expanded and the daily population served has grown. The need for additional fire/police stations is acknowledged. As a result, the Council placed a bond measure placed on the upcoming General Election in November, 2006. A favorable vote on this measure would allow the City to address this critical need in the community.

With the elimination of Public Safety's dependency on General Support Revenues, contingency has been restored to 3% of anticipated operating expenses, a more comfortable reserve given our \$17 million General Fund operations. Additionally more monies are now available for investment in capital projects and the past trend of expending unrestricted ending fund balance will be reversed. In FY'08 another \$500,000 has been added to the contingency fund to safeguard against unknown variables that could impact service delivery.



In addition to the City's formal financial policies there are several long-term practices endorsed by the governing body and incorporated by staff. We acknowledge that a healthy and vibrant community requires the delivery of more than police and fire services. To this end, the allocation of General Support dollars to augment parks, planning, economic development, tourism and downtown as well

as public safety is carefully scrutinized so as to insure one program is not eliminated at the cost of another. The following informal long-term policies have been consistently applied during the budgetary processes:

- 100% of property tax revenues are dedicated to fund the Public Safety program.
- Public Safety program will minimize its reliance upon any General Fund support.
- General Fund will support capital projects, a minimum of \$500,000 annually.
- General Fund will strive to appropriate a 3% contingency based upon total operating costs.
- Tourism program appropriations will not exceed its Transient Room Tax revenue allocation.

On-going Challenges:

Employee benefit costs continue to be a major factor in operating expenses. Like other Oregon governmental entities, unfunded liabilities will cause Grants Pass' rate for Tier1/Tier 2 PERS retirement benefits to increase from 16.05% to 20.58% effective July 1, 2007. The rates for employees hired after August 28, 2003 and covered by the Oregon Public Service Retirement Program (OPSRP) changed to 10.84% for non-sworn personnel and 14.45% for sworn personnel effective March 1, 2006. FY'08 rates could be affected depending upon new actuarial data to be presented by PERS in the autumn of 2006 that will address recent court decisions, legislative changes and fund earnings. The City has been charging, and continues to self-assess PERS rates based on whether an employee holds a sworn or non-sworn position. The amount accumulating in the insurance fund is the differential between the self-assessment and the amount due PERS based upon a composite rate. These monies are now augmenting the bi-weekly payment to PERS.

The City has improved its utilization of medical benefits, resulting in a health insurance premium increase of slightly less than 10% effective January 1, 2006, compared to 25% and 19% in the previous two years. In January, 2006, members of the Grants Pass Employees Association, supervisors and department directors increased their contribution to health care premiums from 7.5% to 10%. Police and fire personnel, however, remain at 7.5% in accord with their contracts that expired December, 2005. The City continues to maintain an Insurance Committee composed of representatives from all labor groups.

While the Committee discusses and evaluates policies and available tax deferral programs, union groups have grieved changes in benefits along the way. Accordingly, labor negotiations with the Grants Pass Police Association and International Association of Firefighters have continued since the fall of 2005, with the cost sharing of health insurance in dispute. Negotiations with both units have progressed through mediation with no resolution and are now scheduled for interest arbitration. The Teamster labor contract that covers personnel working in

parks, street maintenance and the utilities expires December 31, 2006, prompting discussions to commence this fall.

Office space to accommodate necessary staff has generated discussions exploring available options, particularly as it pertains to the municipal building. Council was presented a conceptual plan of “filling in” the entry way off of “A” Street, thereby adding approximately 1,408 square feet to City Hall. Management has resumed working with an architect on other options to demonstrate both short-term and long-term solutions and a new plan will be presented later this year. Regardless of the chosen remedy, some kind of solution will need to be reached within the year.

During FY’07 work will commence on developing the amendment to the urban growth boundary. It involves considerable technical analysis as well as the development and evaluation of growth scenarios and the selection of a preferred alternative. The adopted outcome of the project, estimated to take two years, will identify the future growth boundaries of our community and have significant impacts on current and future infrastructure requirements. This major effort will involve public discussion and will affect all service delivery aspects of the organization.

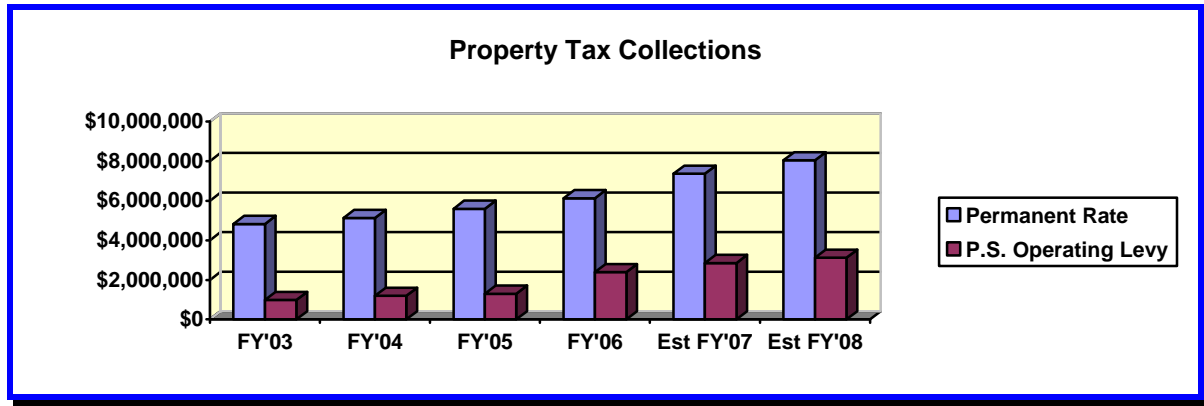
Financial Overview for FY’07

Revenues

The compilation of this two-year operating budget reflects key revenue sources and recommended fee changes outlined below:

Property Taxes – Permanent Rate and Public Safety Local Option Levy

The second and third years of the four-year Public Safety Local Option Levy, together with our permanent property tax rate, are anticipated to fund the entire Public Safety program without any reliance on the General Fund through FY’08. Based upon data known at this time, it appears this coverage will also apply to FY’09, the last year of the levy, with the total tax rate of \$5.6235 per \$1,000/assessed value for the years 2005 through 2009.



Grants Pass' total taxable values have increased as earlier noted. New construction combined with annexations form the basis for the new values. Assessments are estimated to increase a minimum of 19.78% in FY'07, resulting in an increase in tax base levy of \$1.8 million.

Fee in Lieu of Franchise

This fee is a 5% assessment on municipal utilities and was adopted by Council in July, 2005, with implementation beginning in November. The fee arose from the need to uniformly apply assessments on City utilities similar to the franchise fees on public utility providers that install, operate and maintain utility facilities in the right of way. The fee is added to the water and sewer user charges and is paid in full by the customer. These monies become part of General Support revenues used to augment General Fund services that are not self-sufficient. Estimated revenue projections from the fee are \$413,710 in FY'07 and \$427,235 in FY'08.

System Development Charges (SDC)

Water and sewer system development charges were increased to more appropriately reflect the cost and needs of future demands on the respective systems. Following review by Council in the spring of 2005, and the adoption of an updated Capital Improvement Program (CIP), sewer SDCs were implemented September, 2005, with a fee for a single family residence going from \$1,092 to \$2,416. Simultaneously, Water SDC's increased from \$821 to \$2,321 for a single family home based upon needs outlined in the new CIP. The Council chose to also implement annual cost of living increases to these fees beginning January 1, 2007, recognizing realistic market increases in the cost of capital improvements. In this manner, the gap between fees and construction costs should be minimized.

Planning Fees

User fees currently generate about 34% of the revenue for the Planning Division. Staff have been added to meet growing service demands caused by a continuing rise in development activity. Based upon the present fee structure, the percentage of revenues generated from user fees would drop to 28% in FY'07. While an argument can be made that benefiting users pay the full costs of planning services, it is clear that work performed by the Planning Division benefits the entire

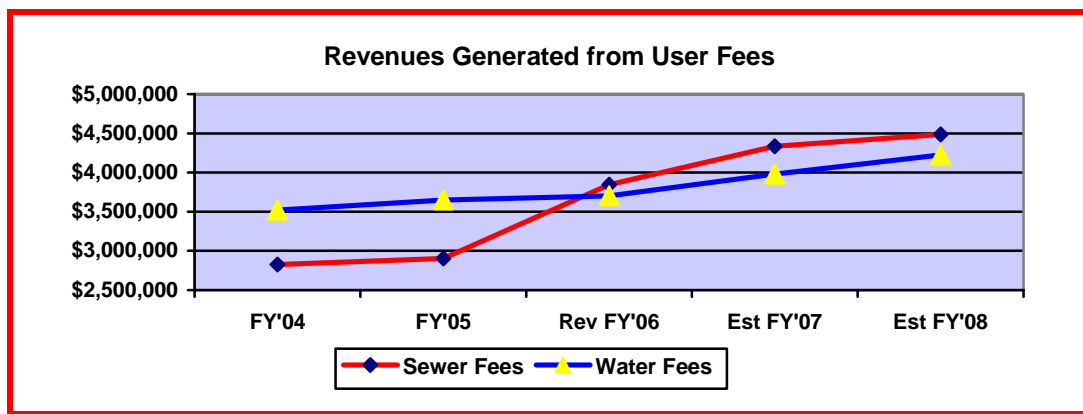
community. Thus, a 25% fee increase effective July 1, 2006 was recommended and adopted, bringing user fee contributions back up to 31% of costs or approximately \$340,000 annually.

Sewer Rate Increases

The operating margin in the Wastewater Fund had been shrinking due to increasing operating costs and the need for capital investment in the treatment plant and collection system. Sewer rates, last changed in 1994, were analyzed by customer and strength of sewage, with new rates adopted for implementation in November, 2005. Having had no change in twelve years, rates were increased 45% to meet system needs. As a result of this change, together with the impact of additions to the system, FY'07 is estimated to generate one million dollars more than originally estimated for FY'06. Similar to the SDC rate changes, Council also implemented an annual cost of living adjustment to the user rates beginning January 1, 2007.

Water Rate Increases

The water system has been reviewed to determine operating costs and capital needs spanning the next 20 years. Consideration was also given to maintenance and demands on the distribution system. The analysis considered the distribution of water system costs among the various user classes, resulting in a new water rate structure that more accurately distributes costs to respective users. A tiered volume charge was created to encourage conservation. Several customer classes were also combined, including irrigation customers, public park and public school customers. The rate structure was adopted by Council in November, 2005, with an implementation date of February 1, 2006. General fee increases were 2.78%. Rates changes include an annual cost of living adjustment beginning January 1, 2007.



Engineering Fees

The City provides engineering services through a self-sufficient internal service fund. A 12% rate increase was adopted for FY'07. Engineering must recover all operating costs through their billable hours for technical services, such as site plan reviews, customer service at the Community Development counter, and inspections on private development to both internal and external customers. These

rates were last increased two years ago and are expected to remain slightly less than billable rates for small firms in the local market. The new rates will be notably less when compared to large firms.

Operating Expenses

An overview of the City's total operating budget shows an increase of 13.25% in costs for the General Fund, Transportation, Water, Sewer and Solid Waste Funds. While this is more than the previous year, it is not unreasonable considering the growth in the community and the increasing demands to expand current service levels.

Change in Operating Budget				
	Revised FY'06	Adopted FY'07	% Change	Projected FY'08
Total Requirements	\$ 31,596,661	\$ 34,942,147		\$ 37,353,192
Less Ending Balance	4,605,663	5,156,006		5,100,805
Less Transfers Out	3,789,105	3,418,867		3,742,707
Less Contingencies	844,668	1,047,164		1,625,769
Net Operating Costs	\$ 22,357,225	\$ 25,320,110	13.25%	\$ 26,883,911

In evaluating the General fund's net operating costs since FY'04, the total change of 30.62%, as shown in the table below, is attributable to several factors.

Employment cost increases are the result of 26.05% increase in health care costs and compounded cost of living adjustments of 11.14% for an increase of 37.19%. This, coupled with the addition of 14 staff to serve a 22.83% population increase is less than the overall increase.

Historical Trends in Growth and Costs								
	Actual FY'04	Actual FY'05	% Change	Rev. FY'06	% Change	Est. FY'07	% Change	Total Change
Growth	25,423	26,085	2.60%	28,335	8.63%	30,450	7.46%	19.77%
COLA			3.02%		4.30%		3.50%	11.14%
Total								30.91%
Net Operating Costs	\$19.385M	\$19.358M	(1.39%)	\$22.357M	15.49%	\$25.320M	13.25%	30.62%

The FY'07 budget calls for the addition of two new Public Safety positions, part of the overall ten positions across the organization. The additions are aimed at maintaining adequate service levels to both internal and external customers as geographical service areas and population increase. As noted previously, property taxes are sufficient to support the police officer and fire supervisor positions. General Support Revenues will be used to fund the addition of a Planner and Parks Maintenance Worker and building permit revenues will fund the clerical position being added to the Building and Safety Division. Charges for services will provide

funding for an Engineering Technician and the Human Resource Manager while also supplementing funding for the planning position. The additions of staff in water and sewer will be supported by their respective user rates.

As mentioned earlier, personnel costs in all operating divisions are affected by retirement and health care costs. The outcome of pending labor negotiations will likewise affect personnel costs and are difficult to accurately estimate at this time. Cost increases for electricity, natural gas, fuel, chemicals and other operational supply needs have been incorporated into each service area represented within this budget document.

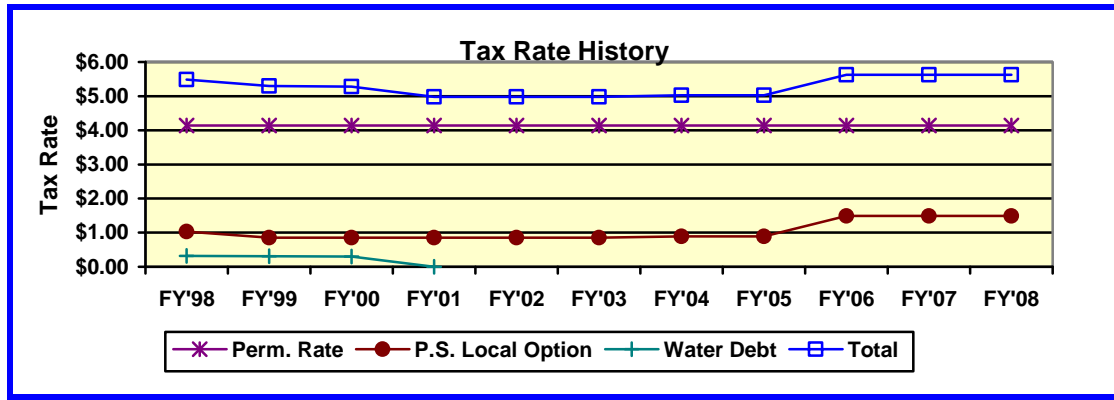
The Administrative Services Fund continues to be supported by a fixed 8% charge applied to the operating costs of each division and 2% on capital projects as it has for more than twenty years. These funds sustain the cost of the City Manager, Assistant City Manager, City Attorney, and associated support staff. The 8% charge also funds Administrative Services functions, including but not limited to, finance and accounting, personnel, audit, budget, and formerly the Information Technology Division. Effective with the Revised FY'06 Budget, the Information Technology Division is now funded separately by a fixed 2% charge on all operations. This provides stable funding for a growing Information Technology Division without overburdening the Administrative Services fund. At the same time, it allows for the accumulation of monies in a reserve for future acquisition of IT hardware and software.

General Fund

Revenues

The General Fund comprises 63.8% of the operating budget. Traditionally, property taxes serve as the major source of funding for general government services such as police, fire, parks, recreation, and planning services. For the first time since 1998, property taxes will be sufficient to maintain the Public Safety program. This means that General Support revenues, largely franchise fees, are available for investment in capital projects and a set-aside contingency equivalent to 3% of the General Fund operating expenses.

Commencing FY'06, a four-year Public Safety Local Option Levy of \$1.49/\$1,000 assessed value, provides for additional personnel, spaced over the four-year period, and meets the Council's objective of maintaining service levels.



Property tax revenues have been forecast using a five-year historical trend in addition to the current taxable value of lands newly annexed during the current fiscal year. Properties included in the November, 2005 and May, 2006, annexations have been added to assess value estimates.

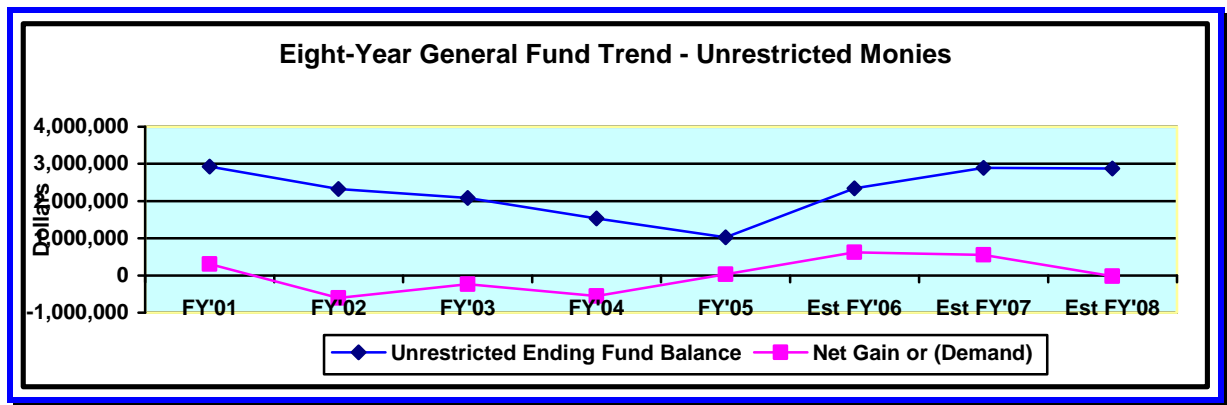
Year	Assessed Value	Value Growth
1997	1,062,137,402	3.21%
1998	968,450,868	(8.82%)
1999	1,068,703,948	10.35%
2000	1,129,100,398	5.65%
2001	1,180,905,168	4.59%
2002	1,253,169,191	6.12%
2003	1,350,701,461	7.78%
2004	1,446,214,463	7.07%
2005	1,579,322,858	9.20%
2006	1,728,922,043	9.47%
2007	Est. 2,057,276,295	18.99%
2008	Est. 2,249,413,246	9.34%

Adopted FY'07 and Projected FY'08 General Fund revenues and sources are summarized in the chart below. For a majority of the revenues, projections are based on a three-year trend together with other factors such as population, utility rate increases, and contracts for services. "Fee in Lieu of Franchise", a new revenue beginning November, 2005, was estimated for water and sewer revenues. Franchise fees and business tax make up the "Other Taxes" shown in the chart.

General Fund Summary of Adopted FY'07 and Projected FY'08 Operating Resources					
	Revised FY'06	Adopted FY'07	Change	% Change	Projected FY'08
Property Taxes	\$ 8,750,146	\$ 10,461,034	\$ 1,719,888	19.66 %	\$ 11,458,423
Other Taxes	2,470,600	2,568,935	98,335	3.98%	2,662,575
Licenses and Permits	973,069	1,008,985	35,916	3.69%	1,019,270
Fee in Lieu of	270,600	413,710	143,110	52.89%	437,235

Franchise					
Other Agency Revenue	1,322,206	1,369,032	46,826	3.54%	1,563,226
Fees & Charges	833,804	840,034	6,230	.75%	768,710
Transfers In	845,925	941,545	95,620	11.30%	970,848
All Other Revenues	802,685	1,092,669	289,984	36.13%	1,146,669
Beginning Balance	3,019,923	3,596,197	576,274	19.08%	4,187,213
Total	\$ 19,288,958	\$ 22,292,141	\$ 3,003,183	15.57%	\$ 24,214,169

Anticipated increases in Transient Room Tax revenues impacts the General Fund as "Transfers In." The elimination of Public Safety's dependency on General Support revenues provides additional fund balance to maintain a more realistic contingency with greater flexibility to meet unknown challenges of the future.



Expenses

General Fund					
Summary of Adopted FY'07 and Projected FY'08 Operating Expenses					
	Revised FY'06	Adopted FY'07	Change	% Change	Projected FY'08
Personal Services	\$ 9,367,381	\$ 10,540,390	\$ 1,173,009	12.52 %	\$ 11,970,458
Materials & Supplies	396,229	419,724	23,495	5.93%	437,880
Contr./Prof. Services	2,776,105	3,430,044	653,939	23.56	3,203,823
Direct Charges	513,431	553,697	40,266	7.84%	595,621
Debt Service	15,281	15,281	0	0%	15,281
Capital Outlay	199,693	191,400	(8,293)	(4.15%)	205,540
Indirect Charges	1,302,143	1,429,839	127,696	9.81%	1,574,417
Sub-Total	14,570,263	16,580,375	2,010,112	13.80%	18,003,020
Contingencies	550,000	665,000	115,000	20.91%	1,205,000
Transfers Out	572,498	859,553	287,055	50.14%	846,400
Ending Balance	3,596,197	4,187,213	591,016	16.43%	4,159,749
Total	\$ 19,288,958	\$ 22,292,141	\$ 3,003,183	15.57%	\$ 24,214,169

Adopted FY'07 operating costs, from a historical perspective, are up 13.80% from Revised FY'06 after eliminating contingencies, transfers out, and ending balance. \$1.5 million of the \$2.0 million increase occurs in the Public Safety program. New positions, together with annual salary adjustments in accord with labor contracts and associated benefit costs, comprise \$854,359. The increase in Contractual Services is \$493,735, nearly \$400,000 of which represents the property tax revenues to be placed into trust to relieve future costs of the Public Safety program. Major changes in the Community Development Program include the addition of a position in the Planning Division and \$108,000 allocated for professional service contracts for necessary urban growth boundary studies.

As indicated earlier in the revenue discussion, the General Fund contingency is being increased from \$350,000 to \$465,000 in Adopted FY'07, to appropriately represent 3% of operating expenses. Another \$500,000 is being set aside in contingency in Projected FY'08. Even with these changes the strength of General Fund revenues permits the unrestricted ending fund balance to remain at the \$4.0 million level.

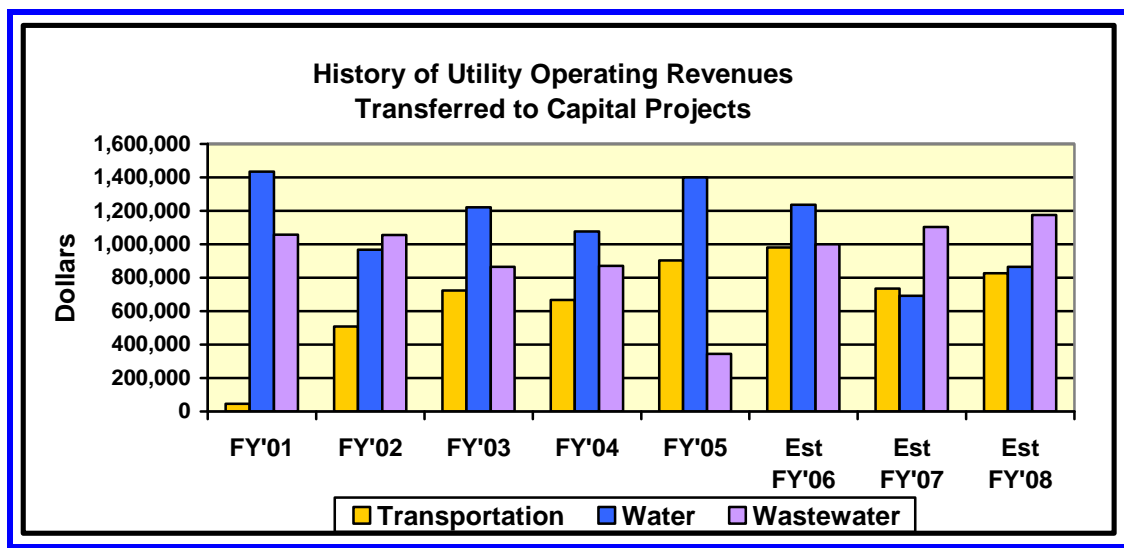
Other Funds

The "Non-General" or "Other Funds" comprise 36.2% of the total budget and include: Transportation, Water, Wastewater and Solid Waste. Each of these funds, sometimes referred to as "enterprise funds", has dedicated revenue source that is tied to their specific programs.

Revenues

While user fees generate the bulk of revenues for water and wastewater, state gas tax coupled with a street utility fee provide the funding for street drainage and maintenance operations. These are projected utilizing actual historical trend data for each fund. In addition, projected housing starts, new commercial and industrial development, as well as actual average water utilization by class are considered in the mix. The budget for each of the utilities transfers the difference between annual operating revenues and expenses to capital projects, making those monies available for reinvestment. System Development Charges, revenue that is development driven, are projected based upon current year activity and are dedicated exclusively to capital projects.

Transportation is anticipated to provide nearly \$750,000 in FY'07 to capital projects for major street maintenance and safety improvements such as sidewalks, bike lanes and traffic signals.



Respective rate increases for water and sewer were implemented during FY'06, and provide a dependable resource for reinvestment in the utility systems as depicted in the chart above. Growth in customer accounts also contributed to the planned surplus between operating revenues and expenses. Customer accounts in the water system have increased 19.6% since 2002, while wastewater system accounts have grown 9.2%, the difference attributable to water customers in the Redwood area receiving sewer services from the Redwood Sanitary Sewer Service District.

Expenses

The nature of utility operations in these "Other Funds" generate personal service costs that are proportionately less than in the General Fund, representing only

31.77% of the net operating budget. Annual debt service payments of \$1.1 million, together with proportionately larger costs for chemicals, electricity, natural gas, and equipment maintenance, account for this variation.

Other Funds					
Summary of Adopted FY'07 and Projected FY'08 Operating Expenses					
	Revised FY'06	Adopted FY'07	Change	% Change	Projected FY'08
Transportation	\$ 2,289,852	\$ 2,280,765	\$(9,087)	(.40) %	\$ 2,427,999
Water	4,692,217	4,603,420	(88,797)	(1.89)%	4,842,801
Wastewater	4,890,057	5,373,787	483,730	9.89%	5,527,659
Solid Waste	617,577	392,034	(225,543)	(36.52)%	340,564
Total	\$ 12,489,703	\$ 12,650,006	\$ 160,303	1.28%	\$ 13,139,023

Declines in both the Transportation and Water Funds provide somewhat less money for transfer to capital projects for reinvestment in the utilities. Less capital funding is available due to increased maintenance activity, chemical/supply costs, and anticipated compensation adjustments. This decline equals \$245,793 for Transportation. For the Water Fund, the decline in capital funds equals \$525,000, due in part to the addition of two staff for the water distribution/sewer collection crew and the need for temporary personnel to backfill the schedule at the Water Filtration Plant while work is being performed on the intake structure this summer. This leaves transfer amounts for capital needs at \$675,000, compared to \$1,200,000 in Revised FY'06. In Projected FY'08, that transfer is anticipated to be up to \$850,000.

Unlike capital funding for Transportation and Water Funds, wastewater capital is increasing and is expected to rise to \$1,100,000 in Adopted FY'07 and increase another \$100,000 in Projected FY'08. The increase primarily results from a substantial increase in sewer user charges and stands in sharp contrast to a capital transfer of \$200,000 in FY'05. Costs related to the Merlin Landfill continue to decline following closure and completion. The City will continue to engage the services of a specially qualified contractor on landfill projects on an "as needed" basis.

Capital Investments

As a thriving and growing community, Grants Pass develops a multi-year investment strategy for its enterprise as well as General Fund activities. New project requests and updates to the status of existing projects are developed by each department and presented for review by the Management Team during the budget review process. Each year the needs are evaluated and revised with options provided to the Budget Committee for consideration. Some of the projects

for the two-year period FY'07 through FY'08 were represented in the previous year's budget deliberation and were modified during the public hearings.

For the utilities, the difference between operating revenues and operating expenditures, which is annually transferred to capital projects, serves as a key element in determining available revenue improvements. While the growth the community is experiencing has resulted in the receipt of significant System Development Charge fees, use of these monies is restricted by State statute.

The water and sewer utility capital improvement programs, adopted by Council in May, 2005, identified plant upgrades and capacity expansion requirements for both utility systems. Estimates for water system improvement needs through 2024 are estimated to cost \$33.5M while the upgrades, expansion and structural repairs to the sewer system, will require \$33.7M.

The sewer rate changes implemented in October, 2005 should provide necessary revenues to meet the immediate needs for repairs and upgrades to the collection system as well as Phase II of capacity expansion at the restoration plant. Similarly, the water rate changes implemented in February, 2006 are anticipated to provide sufficient resources to meet regulation upgrades to the treatment facility and capacity expansion, both in terms of water lines, reservoirs and pumping capacity.

Commencement of modification work on the intake structure at the water filtration plant, a \$1.6M project, began in FY'06 and is anticipated to be completed October, 2006. While the project will ultimately provide added capacity as well as meet federal and state fisheries regulatory requirements, construction has resulted in additional operating costs. Intake restrictions resulting from river work has impacted personnel costs, most noticeably shift changes and overtime in order to maintain reservoir levels, particularly during the peak production months.

The Solids Handling project, which includes testing, evaluating and implementing the most cost effective method of solids disposal from the water filtration plant, also continues to elevate operating costs. An extensive evaluation of all potential solid handling options in FY'06 has resulted in continued short term use of geo-tubes. These non-reusable tubes are expensive, require additional chemicals, necessitate added operational time for the cleaning of basins, and are labor intensive to fill and haul away. Production costs will remain elevated until the permanent solution of pumping all solids to the wastewater treatment plant is phased in and completed in FY'09.

Other major water projects include the \$1.1M extension of lines in zone 2 to better serve homes in higher elevation areas as well as to provide for future industrial development and the installation of a 12-inch waterline in 4th Street. This should accommodate abandonment of a similar size line that runs under the Caveman Plaza, a commercial business complex.

The most significant sewer capital project is the Pine Street/Booth Sewer Replacement, a \$4.1M project ranked as a top priority in the Wastewater Collection System Master Plan adopted by the Council in September, 2004. Improvements to this significant conveyance line will eliminate surcharging during winter storm events and mitigate sink holes in Pine Street. Simultaneously, upgrades to the influent pump and the addition of a second bar screen at the restoration plant are in design phase. When this \$2.6M project is completed in the winter of 2007, maintenance costs will be reduced while capacity will be expanded from 30 to 38 million gallons per day.

The General Fund has the financial ability to commit \$750,000 to Transportation and Lands and Building Capital project programs. This differs significantly from the past several years when annual commitments between \$265,000 and \$500,000 were the norm. System Development Charges, Local Improvement Districts and dedicated capital financing revenues continue to provide the available funds to finance projects in Lands and Buildings and Transportation. Implementing the Council's goal of providing outstanding park facilities throughout the community, FY'07 capital projects emphasize acquisition of future park land, park development through partnerships with non-profit organizations, and river front trail construction.

Implementation of the Street Utility Fee in October, 2003, the Storm Drainage System Development Charge in March, 2004, and the Redwood Signal System Development Charge in April, 2005 have accelerated the City's ability to address a variety of transportation issues facing the community. This \$831,308, together with Transportation System Development Charges generated by development, grant monies, and contributions from the Redevelopment Agency, will provide a total of \$3.2M for the following major FY'07 projects:

- Rogue River Highway Pedestrian Improvements, including pedestrian, bicycle and landscaping improvements for safer facilities from Parkdale Drive to Cloverlawn Drive at a cost of \$1.2M.
- Installation of a traffic signal at Dowell and Redwood Avenue to improve traffic flow and meet intersection standards, at a project cost of \$350,000.
- Widen and/or extend several roadways including West Park Street, Dowell Road frontage, and G.I. Lane, at a cost of \$1.1M.
- Reconstruction of Washington Boulevard from Evelyn to Savage Street at a cost of \$670,000.

Local Improvement Districts (LIDs), are anticipated as a funding mechanism for a number of roadway projects. Usually initiated by property owners desiring infrastructure improvements, such as street, curb, gutter, sidewalk, water or sewer lines, LIDs' provide the financing tool for property owners to repay the City over a period of 10 to 20 years for the improvements made. Projects anticipated for the FY'07-FY'08 period include:

- Major widening with a third turn lane and installation of curb, gutter and sidewalk along Redwood Avenue from Redwood Circle to Dowell Lane at a cost of \$2.8M.
- Widening on Darneille Lane from Redwood Avenue and Leonard Road with installation of bike lanes, sidewalks, and planter strips at a cost of \$1.25M.
- Installation of sidewalks in safety zone designated areas such as Martin Park, 10th Street in the vicinity of Lincoln Elementary School, and Western Avenue \$168,000.

Grant monies, System Development Charge revenues, proceeds of bond and land sales, and support from the General Fund are the primary revenues sources for Lands and Building capital projects. Assuming a General Obligation Bond is the most viable financing tool, a \$9.5M bond sale will support the construction of two new fire/police stations south of the river. Bond proceeds are also slated to cover acquisition of fire apparatus equipment. The impact of additional staffing needs and increased building maintenance costs have been considered and included in the Public Safety operating program budgets for both FY'07 and FY'08.

A \$480,000 state grant will be used to initiate Phase I development of Redwood Park, including playground, soccer field and restroom facilities. Off-site improvements have been budgeted and the recognition of additional maintenance costs, both labor and materials, have been included in the Parks budget. The completion of Morrison Centennial Park in 2005, together with these planned improvements, have necessitated the request and approval for an additional parks worker in FY'07.

Other improvements slated for FY'07 include:

- Property acquisition and easements for the Rogue River Riverfront path.
- Acquisition of stormwater detention site in the Allen Creek Watershed.
- Land purchase for future park sites and planned trails in the northeast and southeast sectors of the community as well as enhancements at Riverside Park and Reinhart Volunteer Sports Park.
- Additional public parking in the downtown area enhanced by fountain and neighborhood park.

In Conclusion

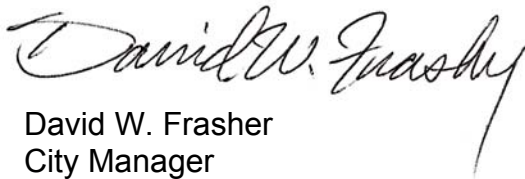
We have an innovative government that is focused on value. Our employees demonstrate a willingness to seek and create alternative solutions to problems. City staff value teamwork while honoring the individual contributions of fellow employees, volunteers and our governing body. Through this budget we are recognizing the needs of today as well as the future by planning strategically and

implementing measurable objectives of our work plan to “honor the past while building a hometown for our children’s children.”

This operating budget adds capacity to the City organization, evolving to support the vision created by our elected officials as our City continues to change. We are delighted with the continued performance of our organization, and we believe that the City offers an exceptional value in the services it provides.

In closing, I would like to acknowledge the teamwork, commitment, and assistance of Budget Committee members and City staff in the preparation of this budget document. In particular, special appreciation is warranted for Administrative Services Director, Joanne Stumpf, whose tireless dedication and professionalism have helped garner Grants Pass an impressive record of multiple awards from the Government Finance Officers Association for outstanding budget preparation.

Sincerely,

A handwritten signature in black ink, reading "David W. Frasher". The signature is written in a cursive, flowing style with a long, sweeping tail on the last letter.

David W. Frasher
City Manager